

**City of Pontiac  
General Employees' Retiree Health  
and Insurance Benefits Trust**

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**Financial Report  
December 31, 2010**

# **City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust**

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## Independent Auditor's Report

To the Board of Trustees  
City of Pontiac General Employees' Retiree  
Health and Insurance Benefits Trust

We have audited the accompanying statement of trust net assets of the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (a component unit of the City of Pontiac, Michigan) as of December 31, 2010 and the related statement of changes in trust net assets for the year then ended. These financial statements are the responsibility of the board of trustees of the City of Pontiac General Employees' Retiree Health and Insurance Benefits Plan and Trust. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust as of December 31, 2010 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and required supplemental information (identified in the table of contents) are not required parts of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

*Plante & Moran, PLLC*

June 28, 2011

# City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust

## Management's Discussion and Analysis

### Using this Annual Report

This annual report consists of two parts: (1) management's discussion and analysis (this section) and (2) the basic financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

### Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Fiscal Year Ended	
	December 31	
	2010	2009
Total assets	\$ 456,405	\$ 6,318,779
Total liabilities	136,206	110,795
Trust net assets	<b>\$ 320,199</b>	<b>\$ 6,207,984</b>
Net investment gain	\$ 548,273	\$ 1,028,198
Contributions - Employer	3,141,083	400,945
Retirees' health benefits paid	(9,551,730)	-
General and administrative expenses	(25,411)	(17,382)
Net (decrease) increase in trust net assets	<b>\$ (5,887,785)</b>	<b>\$ 1,411,761</b>

### Overall Fund Structure and Objectives

The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (the "Trust") exists to pay healthcare benefits to retired members. The Trust is currently accumulating assets to generate investment earnings and there are no benefits currently being paid. The excess of contributions over benefits paid will allow for additional funding to increase investment income to a level where the Trust will generate adequate earnings to pay future benefits. The public capital markets represent the primary source of investments.

# **City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust**

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## **Management's Discussion and Analysis (Continued)**

### **Asset Allocation**

The Trust has invested in a balanced mutual fund that provides exposure to both the equity and fixed-income markets. Once an adequate funding level is established, the Trust is expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Trust.

### **Investment Results**

2010 marked the second year of economic recovery from the great recession. Inflation was under control; however, commodity prices rose sharply during the second half of the year. Central banks maintained accommodative policies, holding interest rates down (at near historic low levels). The fixed-income market, as measured by the Barclays Aggregate Index, returned 6.5 percent for the year. The equity markets posted solid returns for the second consecutive year (albeit lower than 2009); the S&P 500 rose 15.1 percent, the Russell 2000 Index (a proxy for U.S. small-cap stocks) jumped 26.9 percent, and the MSCI EAFE Index (a proxy for international stocks) gained 7.8 percent. For the year ended December 31, 2010, the total Trust had investment income of \$548,273, with total plan additions of \$3,689,356, and paid \$6,588,225 to the City of Pontiac to reimburse healthcare expenses, along with paying other administrative expenses of \$25,411. In addition, the City paid \$2,963,505 for premiums for retirees, which under GASB 45 are shown as both contributions and benefit payments of the plan.

The total Trust's return must always be considered in a longer-term context. The Trust's investment horizon is long term, corresponding to the long-term nature of the Trust's liabilities. Therefore, the board of trustees establishes an asset allocation policy to control risks and generate expected returns that will enable the Trust to pay the benefits promised to members and retirees. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the Trust over many years, not just one or two years.

**City of Pontiac  
General Employees' Retiree Health  
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**Statement of Trust Net Assets  
December 31, 2010**

**Assets**

Investments at fair value - Mutual funds (Note 2)	\$ 454,624
Due from the City of Pontiac	<u>1,781</u>
Total assets	456,405

**Liabilities**

Due to Police and Fire Retirement Systems	45
Due to General Employees' Retirement System	134,301
Accounts payable	<u>1,860</u>
Total liabilities	<u>136,206</u>

**Trust Net Assets**

**\$ 320,199**

# **City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust**

## **Statement of Changes in Trust Net Assets Year Ended December 31, 2010**

### **Additions**

Contributions	\$ 3,141,083
Investment income:	
Interest and dividend income	127,504
Net increase in fair value of investments	<u>420,769</u>
Net investment income	<u>548,273</u>
Total additions	3,689,356

### **Deductions**

Professional services	(25,411)
Retirees' health benefits	<u>(9,551,730)</u>
Total deductions	<u>(9,577,141)</u>

**Net Decrease in Trust Net Assets** (5,887,785)

**Trust Net Assets - January 1, 2010** 6,207,984

**Trust Net Assets - December 31, 2010** \$ 320,199

# **City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust**

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**Notes to Financial Statements  
December 31, 2010**

## **Note I - Summary of Significant Accounting Policies**

The City of Pontiac (the "City") has established an irrevocable prefunded group health and insurance trust fund, the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (the "Trust"), for health, optical, dental, and life insurance benefits for retirees who are members of the General Employees' Retirement System of the City of Pontiac (the "System"). Currently, the Trust is in the preliminary phases of accumulating assets to build a corpus, after which point investment earnings will be used to pay these benefits. The Trust was created as an Internal Revenue Code 501(c)(9) Trust (VEBA). The System performs the Trust's accounting function.

**Reporting Entity** - The Trust is a component unit of the City of Pontiac, Michigan (the "City"). The Trust does not hold securities of or loans to the City or the General Employees' Retirement System.

**Plan Sponsor Financial Condition** - The City of Pontiac (the plan sponsor) is experiencing significant financial difficulty. The City is currently in receivership under Michigan Public Act 4 of 2011. The result is that the State has appointed an Emergency Manager to control the finances of the City. Uncertainty exists regarding the City's ability to continue to make contributions to the plan. Contributions that were scheduled to be made for the year ended December 31, 2010 in the amount of \$167,949 were not remitted to the plan by the City and the City has stated that they do not intend to make these contributions. These amounts are not reflected in the financial statements.

**Basis of Accounting** - The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust's statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Insurance costs are recognized when due and payable in accordance with the terms of the Trust.

**Investments** - Investments are reported at fair value. Mutual fund investments are valued at net asset value. Dividend income is recorded on the ex-dividend date. Income from other investments is recorded as earned on an accrual basis. In accordance with the policy of stating investments at fair value, net unrealized appreciation or depreciation for the year is reflected in the statement of changes in trust net assets.

**Federal Income Taxes** - The Trust is exempt from income tax under Section 501(a).



**City of Pontiac  
General Employees' Retiree Health  
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**Notes to Financial Statements  
December 31, 2010**

**Note 2 - Investments**

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The System is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The trust fund is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The System has designated one bank for the deposit of its funds. The System's deposits and investments are in accordance with statutory authority.

The System's cash and investments are subject to two types of risk, which are examined in more detail below:

**Interest Rate Risk**

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System does not have an investment policy that restricts investment maturities. At year end, the average maturities of investments are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Weighted Average Maturity</u>
Mutual fund	\$ 173,666	7.0 years

**City of Pontiac  
General Employees' Retiree Health  
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**Notes to Financial Statements  
December 31, 2010**

**Note 2 - Investments (Continued)**

**Credit Risk**

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Trust has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities are as follows:

Investment	Fair Value	Rating	Rating Organization
Mutual fund	\$ 133,202	AAA	Moody's
Mutual fund	8,162	Aa	Moody's
Mutual fund	17,540	A	Moody's
Mutual fund	14,762	Baa	Moody's

**Note 3 - Trust Contribution Information**

The Trust is funded by employer contributions. The City is required to make minimum contributions in the amount of 3 percent of valuation payroll unless a lesser amount is actuarially determined to be necessary to actuarially fund the Trust. The ordinance that established the Trust requires annual funding of the actuarial rate or 3 percent of valuation payroll. Under GASB 45, premiums paid directly by the City for retirees covered by the VEBA are included as employer contributions to the Trust along with an offsetting benefit expense.

**Note 4 - Trustees**

The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust as of December 31, 2010 has two trustees who sit by virtue of their position, one who is appointed by the City of Pontiac General Employees' Retirement System, one appointed by the City Council of the City of Pontiac, and one who is elected by the retirees.

**City of Pontiac  
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**Notes to Financial Statements  
December 31, 2010**

**Note 5 - Membership Data**

At December 31, 2008, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	<u>751</u>
Current employees:	
Fully vested	129
Nonvested	<u>157</u>
Total	<u>286</u>

**Note 6 - Postemployment Benefits**

**Plan Description** - The City provides retiree healthcare benefits to eligible employees and their spouses through the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust. This is a single employer benefit plan administered by the City of Pontiac General Employees' Retirement System.

The Trust's financial statements are included in the City of Pontiac's financial report and can be obtained by writing to 47450 Woodward Ave., Pontiac, MI 48342.

**Funding Policy** - The City is required by ordinance to contribute 3 percent of eligible payroll toward pre-funding unless an actuarial valuation requires a lesser amount. During the City's fiscal year ended June 30, 2010, the City made payments for postemployment healthcare premiums of \$6,578,184, plus it contributed \$379,365 into the Trust which is reported in the City's financial statements as a Pension and Other Employee Benefits Trust Fund. During the year ended December 31, 2010, the Trust reimbursed the City for healthcare premiums paid by the City in the amount of \$6,588,225, which represented payments made by the City for the period from July 1, 2009 through June 30, 2010. Additionally, for the period from July 1, 2010 through December 31, 2010, the City has estimated the Trust's portion of healthcare premiums paid by the City to be \$2,963,505 which is reflected as additional contributions to the plan and benefit payments made from the plan during the current year, pursuant to governmental accounting standards.

# City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust

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## Notes to Financial Statements December 31, 2010

### Note 6 - Postemployment Benefits (Continued)

The funding progress of the Trust as of December 31, 2008 (the most recent valuation date) is as follows:

Actuarial value of assets	\$ 4,796,224
Actuarial accrued liability (AAL)	\$ 226,279,072
Unfunded AAL (UAAL)	\$ 221,482,848
Funded ratio	2.12%
Annual covered payroll	\$ 14,414,481
Ratio of UAAL to covered payroll	1,536.53%

**Actuarial Methods and Assumptions** - Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The required schedule of funding progress immediately following the notes to the financial statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

# **City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust**

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**Notes to Financial Statements  
December 31, 2010**

## **Note 6 - Postemployment Benefits (Continued)**

In the December 31, 2008 actuarial valuation (the most recent available actuary report), the entry age actuarial cost method was used. The actuarial assumptions included a 5.0 percent investment rate of return compounded annually (net of administrative expenses), which consists of a real rate of return of .5 percent per year plus a long-term rate of inflation of 4.5 percent per year. It also included healthcare cost increases ranging from 4.5 to 10.0 percent for the years included in the valuation. The actuarial value of assets is set to equal fair market value. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2008 was an open 30-year period.

## **Required Supplemental Information**

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**City of Pontiac  
General Employees' Retiree Health  
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**Required Supplemental Information  
Schedule of Analysis of Funding Progress**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/04	\$ 3,202,351	\$ 139,925,086	\$ 136,722,735	2.3	\$ 21,210,461	644.60
12/31/05	3,973,887	157,048,845	153,074,958	2.5	16,751,815	913.78
12/31/06	4,928,700	154,823,626	149,894,926	3.2	14,996,753	999.52
12/31/07	5,682,510	159,345,212	153,662,702	3.6	13,559,473	1,133.25
12/31/08	4,796,224	226,279,072	221,482,848	2.1	14,414,481	1,536.53

**City of Pontiac  
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**Required Supplemental Information  
Schedule of Employer Contributions**

Year Ended June 30	Annual Required Contribution*	Amount Contributed**
2009	\$ 10,674,833	\$ 7,450,360
2010	9,759,248	379,365

\* GASB Statement No. 45 was adopted by the City for the City's fiscal year ended June 30, 2009. As such, the amount contributed corresponds to the City's fiscal year end (pursuant to GASB Statement No. 45) as opposed to the Trust's calendar year end.

\*\* In accordance with GASB Statement No. 45, the amount contributed for 2010 includes prefunding of \$379,365. Current year premiums of \$6,578,184 were paid by the City but subsequently reimbursed by the Trust.